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Supreme Court of the United States

OCTOBER TERM, 1947

No. 16

PRIEBE & SONS, INC.,
Petitioner,

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS OF THE UNITED STATES

BRIEF FOR PETITIONER

OPINIONS BELOW

The majority and dissenting opinions of the Court of Claims of the United States (R. 33–40) are reported in 106 C. Cls. 789.

JURISDICTION

The judgment of the Court of Claims was entered May 6, 1946 (R. 40), and its order denying the petitioner's motion for a new trial was entered October 7, 1946 (R. 40). The petition for writ of certiorari was filed January 7, 1947, and was granted March 10, 1947 (R. 41). Jurisdiction is conferred on this Court by section 3(b)

of the Act of February 13, 1925, 43 Stat. 936, 939, as amended by the Act of May 22, 1939, 53 Stat. 752.

QUESTION PRESENTED

Whether the provision of paragraph 7 of the contract under which damages were imposed on the petitioner was an invalid provision for a penalty or an enforceable provision for liquidated damages.

STATEMENT

The facts, found with substantial accuracy by the Court of Claims (R. 18–32), are briefly these:

The petitioner corporation and the Federal Surplus Commodities Corporation, a United States agency hereinafter called FSCC, entered into a contract on April 23, 1942, for the sale to FSCC of dried eggs (R. 18, 19). The contract provided that the petitioner would make, and the FSCC would accept, delivery at some time within a ten-day period beginning May 18, 1942, but that the particular day and the quantities of eggs and the places to which they were to be shipped were at FSCC's option (R. 19, 22, 24, 25).

The FSCC by various notices (one within the ten-day period, one before, and two after such period) directed petitioner to make immediate shipment of specified quantities of the dried eggs (R. 26, 27). These notices were promptly followed by delivery of the eggs (R. 26, 27, 29, 30). FSCC accepted the product and has never questioned its quantity or quality, nor the time or place of delivery (R. 27).

After the acceptance of the eggs, FSCC imposed damages of $11,736.40 on petitioner, based upon a contract provision calling for "liquidated damages" at ten cents a pound on so many pounds of the eggs (then stated to

amount to 117,364 pounds) as to which inspection certificates were not ready on May 18 (R. 22, 23, 27, 28). Seventeen months later, and after the petitioner had filed this suit, FSCC notified petitioner that a further sum of $2,746.50 was being imposed with respect to an additional 27,465 pounds as to which the certificates were not ready on May 18 (R. 29). After FSCC deducted the last mentioned sum from another contract payment due it, the petitioner amended its complaint and increased the amount sought to the total sum of $14,482.90, together with interest (R. 1, 7, 29).

The contract was made up of an announcement by FSCC soliciting offers, petitioner's offer, and FSCC's acceptance (R. 24). Paragraph 9 of the announcement (hereinafter referred to as paragraph 9 of the contract) provided that, since "the failure of the vendor to deliver the quantity of the commodity * * * specified * * * in accordance with the terms * * * will * * * cause serious and substantial damages to the purchaser," and since "it will be difficult, if not impossible, to prove the amount of such damages, the vendor agrees to pay to the FSCC liquidated damages" (R. 22, 23). Under paragraph 9 the rate of damages in different contracts would vary according to the number of days between the date when the offer was accepted by the FSCC and the date specified in the offer (first day of the ten-day period), but the rate in any one contract would always be the same and would not vary by reason of the extent of any delay in delivery (R. 23). If the first day of the ten-day period was within 50 days of the date of FSCC's acceptance of the seller's offer, the rate of liquidated damages for that particular contract was to be 10 cents a pound (R. 23). The rate per pound was to increase by a graduated scale up to 30 cents a pound, which was the rate if the first

day of the ten-day period were from 246 to 311 days after the contract (acceptance) date (R. 23). As the first day of the ten-day period in this case (May 18, 1942) was within 50 days of the contract date (April 23, 1942), damages were to be imposed at the rate of 10 cents "for each pound * * * undelivered" regardless of the kind or extent of delay (R. 23, 24).

Paragraph 7 of the contract provided that "failure to have specified quantities of dried egg products inspected and ready for delivery by the date specified [May 18, 1942] * * * will be cause for invoking the provisions of paragraph 9" (R. 22).

The contract provided that the vendor should arrange with an agency of the United States for inspection of the product, and should tender a grading certificate with each delivery (R. 20–22). The barrels used in shipping were to be marked with certain information concerning the product, the vendor, and the manufacturer, including a legend furnished by the FSCC (R. 21, 22).

The eggs as to which the damages were imposed had all been manufactured before May 18, 1942, and the eggs themselves were ready for delivery before that date, but the grading certificates of the Government which showed that the product was acceptable bore dates of May 20, 21, and 22, 1942 (R. 26, 27). The fact that these certificates were dated subsequent to May 18, 1942, was the basis for the imposition of damages (R. 30). The first notice to ship any of the eggs as to which damages were imposed was dated May 26, 1942 (R. 26). The other notices to ship were dated May 29 and June 4, 1942 (R. 26, 27), and with respect to the two notices last mentioned the Government itself was in default (R. 22) but no point concerning such default has been made in this case by petitioner.

The petitioner sued in the Court of Claims to recover the amount withheld with interest (R. 1, 7), but that Court, with one judge dissenting, held that the imposition of damages was proper (R. 32, 39).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Claims erred:

1. In holding that the provision in question was an enforceable provision for liquidated damages rather than an invalid penalty clause.

2. In failing to hold that the amount fixed as damages for mere omission to have the certificates ready May 18, 1942, was not a reasonable forecast of just compensation for such a technical breach, and that accordingly the provision was unenforceable.

3. In failing to hold that the amount fixed as damages for mere omission to have the certificates ready May 18, 1942, was intended to be held *in terrorem* over the petitioner, and to force performance through the excessiveness of the amount, rather than to be a good faith preestimate of anticipated damages, and in failing to hold, as a consequence, that the provision was a penalty clause.

4. In attaching conclusive weight to the use of the contract term "liquidated damages" in holding that the provision was enforceable.

5. In dismissing the petition.

6. In denying the motion for a new trial.

SUMMARY OF ARGUMENT

The petitioner contracted with the FSCC to sell dried eggs. The contract provided that the petitioner should deliver the eggs at such times during a ten-day period commencing May 18, 1942, as the FSCC might select,

and that the quantities and destinations of shipments were subject to the FSCC's instructions. The petitioner was not obligated, nor even permitted, to make delivery until the FSCC gave notice of the time to deliver and the other necessary instructions.

The petitioner made deliveries according to the contract immediately upon receipt of shipping instructions and the FSCC accepted the eggs. Some time later, however, after examining various papers, the FSCC imposed damages under paragraph 7 of the contract merely because grading certificates were not ready on May 18.

The contract (paragraph 9) provided for damages for failure to deliver in accordance with the contract. This provision covered every failure which could possibly injure the FSCC. But a separate provision (paragraph 7) also provided for the same rate of damages if the certificates were not ready on May 18. Since every failure to deliver was covered by paragraph 9, the damage provision in paragraph 7 could only come into play if delivery were made in conformity with the contract. Accordingly, when the contract was entered into it was certain that the FSCC could not be injured if the petitioner made delivery according to the contract and there should be a mere failure to have the certificates ready on May 18.

The provision for damages for such a technical omission without possibility of injury could not have been inserted in the contract as a reasonable forecast of just compensation for harm anticipated from such an omission. Nor could it have been included in the contract to give the FSCC mental assurance that the certificates would be ready on May 18 since there was no procedure for advising the FSCC, until long after the fact, whether the certificates were ready on May 18. The provision could have been devised only to be held *in terrorem* over

the petitioner in order to force performance through fear of a heavy exaction. Therefore, in holding that damages were properly imposed, the decision below is in plain, flat, and hopeless conflict with the long-established fundamental of contract law that to be enforceable a contractual provision fixing damages for a future breach must reflect a reasonable forecast of the damage likely to result from that breach.

ARGUMENT

I

Performance was not due from the petitioner until the FSCC requested delivery.

The contract was for the sale of eggs. The agreed time for performance was not a fixed date, but any time or times chosen by the FSCC, pursuant to the option contained in paragraph 7, within the ten-day period beginning on May 18 (R. 14). The FSCC also had the right to direct where and in what quantities the eggs were to be delivered (R. 24, 25).

It is thus clear that performance by the petitioner was not due, nor even possible, until request was made and instructions given for delivery. This is so obvious that it would be superfluous to cite the many decisions from Williston, Sales (2d ed.), § 457, to show that the request and instructions were conditions precedent to the petitioner's performance of its duty to deliver the eggs.

II

The contractual provision under which damages were imposed upon the petitioner provided for damages because the certificates were not ready on a certain day, notwithstanding (1) that the FSCC did not request delivery until a later day, and (2) that delivery was made in strict conformity with the

contract; it was accordingly known when the contract was made that the FSCC could not suffer any damage whatever from the mere omission for which the damages in this case were imposed.

The petitioner in this case made all deliveries, promptly upon request by the FSCC, in strict conformity with the contract. The sole reason for the imposition of damages was that the certificates giving rise to this controversy were not ready on May 18, the first day of the ten-day period within which the FSCC could request delivery.

Paragraph 9 of the contract clearly provided for damages if there were any failure to deliver in accordance with the contract (R. 22, 23). Delivery could not properly be made unless the certificates were ready by the time when delivery was requested. If the FSCC had requested delivery on May 18, or on any of the nine days thereafter, and the petitioner had not complied (whether for failure to have the certificates ready or for any other reason), the damages would have been due under paragraph 9.

The only other provision of the contract imposing damages was the entirely separable provision of paragraph 7. This paragraph provided for damages (at the rate specified in paragraph 9 for failure to deliver) if the certificates were not ready on May 18 even though the petitioner should have them ready when the FSCC requested delivery and should make immediate delivery upon such request.*

It is thus clear that the contract did not provide for damages, beyond the provision in paragraph 9 which applied to all cases of failure to deliver in accordance

* This is the interpretation given to paragraph 7 in the majority opinion below (R. 36, 37) accepted for the purpose of this brief.

with the contract, except in the one very special case covered in paragraph 7. This one case was where three conditions were all present, namely, (1) the certificates were not ready on May 18, (2) the FSCC did not request delivery until a later day, and (3) delivery was made in accordance with the contract. If the FSCC requested delivery on May 18, and the certificates were not ready, then the damages would be due under paragraph 9 for failure to deliver. Or if, for some other reason, delivery was not made in accordance with the contract, the damages would likewise be imposed under paragraph 9. In neither of these cases would paragraph 7 be applicable. In other words, paragraph 7 could have application only if, as in the present case, the FSCC made its request (for delivery) after May 18, and that request was observed, and delivery made in conformity with the contract.

The only thing that could possibly injure the FSCC would be failure to get proper performance when delivery was requested. The FSCC was not interested in the certificates except as one essential of proper delivery of certificated eggs. There was no provision in the contract for currently advising the FSCC that the certificates were or were not ready on May 18, and in fact the FSCC had no knowledge until long after the deliveries had been made and accepted that the certificates were not ready on May 18.

If the petitioner had been able to perform on May 18, but because of a better offer or for other reason had refused to perform when request for delivery was made, damages could not have been imposed under paragraph 7. Nevertheless, in such case the injury and damages would have been the same as if there had been no ability to perform when the request was made. And it is

equally certain that the FSCC could not suffer damage merely because some preliminary, such as a certificate, was not ready on a specified day before performance was due, provided delivery was properly made upon request. Accordingly, when the contract was entered into it was as certain as it proved to be later that the FSCC could not suffer any damage whatever from the omission for which the damages in this case were imposed.

III

The provision under which damages were imposed was an unenforceable penalty rather than a liquidated damages provision since it was not a reasonable forecast of probable damage, but was from the outset an attempt to impose damages where the FSCC could not suffer any injury whatever.

The principles of general contract law are equally applicable to the Government.

This Court has held that the principles of general contract law are normally applicable to the Government as well as to private parties. *United States* v. *Standard Rice Company, Inc.*, 323 U. S. 106, 111; *Hollerbach* v. *United States*, 233 U. S. 165, 171, 172. The English case of *Clydebank Engineering and Shipbuilding Co., Ltd.*, v. *Castaneda*, (1905) A. C. 6, which involved a case of non-delivery of certain boats, does not state a contrary rule in England, but merely points out the desirability in government war contracts of setting up true liquidated damages provisions for non-delivery.

The reasonable forecast principle of general contract law makes a damage provision unenforceable unless the amount fixed is a reasonable forecast of probable damage.

The reasonable forecast principle is a well-established principle of general contract law which has a long history beginning with the earliest attempts of courts of equity to relieve parties from harsh contract damage provisions. Under this principle a provision for a sum disproportionate to the damages which *at the time the contract was entered into* could have been reasonably anticipated as a probable result of a subsequent breach of the contract will be held unenforceable. *Kothe* v. *Taylor Trust*, 280 U. S. 224, 226; *Wise* v. *United States*, 249 U. S. 361, 365–367; *United States* v. *Bethlehem Steel Co.*, 205 U. S. 105, 121; *Sun Printing & Publishing Association* v. *Moore*, 183 U. S. 642, 672–674.

The universality of the "reasonable forecast" rule is clearly shown in Restatement, Contracts, § 339, p. 552, and in Williston, Contracts (Rev. ed.), §§ 776–784, where many cases are cited.

This principle is set forth in Restatement, Contracts, § 339, p. 552, thus:

> "An agreement, made in advance of breach, fixing the damages therefor, is not enforceable * * * unless
>
> "(a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach * * *."

The Federal law controls, but this is unimportant since the reasonable forecast principle is so uniformly established.

The validity of the damage clause in paragraph 7 of the contract is rather clearly governed by Federal law. *United States* v. *Allegheny*, 322 U. S. 174, 183; *Clearfield Trust Co.* v. *United States*, 318 U. S. 363, 366, holding inapplicable the rule of *Erie Railroad Co.* v. *Tomp-*

kins, 304 U. S. 64. But it does not seem important whether the case is controlled by Federal law or by the law of the District of Columbia or of some state. In the usual case the validity of liquidated damages is determined by the law of the place of contracting. Goodrich, Conflict of Laws (2d ed.), § 88, p. 218. The contract was entered into, either in the District of Columbia where the contract was accepted, or in Illinois which was the situs of the petitioner's principal place of business where the petitioner performed all its acts leading up to the making of the contract. The contract was to be performed in Iowa and Minnesota. Regardless of whether the case is to be decided under Federal law or under the law of one of the other jurisdictions, the enforceability of the damage provision is controlled by the same fundamental and hitherto almost universally recognized principle of law. *Davy* v. *Crawford*, 79 U. S. App. D. C. 375; *Fort Dodge Co-operative Dairy Marketing Association* v. *Ainsworth*, 217 Iowa 712, 716; *Holt* v. *Doty*, 193 Iowa 582; *Meuwissen* v. *Westerman Lumber Co.*, 218 Minn. 477, 483, 486; *Goodell* v. *Accumulative Income Corp.*, 185 Minn. 213, 215-216; *Schommer* v. *Flour City Ornamental Iron Works*, 129 Minn. 244, 246, 247; Prentice, Liquidated Damages in Illinois, 31 Ill. L. Rev. 879; Williston, Contracts (Rev. ed.), §§ 776–784.

The Bethlehem case on which the Court below relied is consistent with the reasonable forecast principle.

In the single case cited by the Court of Claims (R. 38), *United States* v. *Bethlehem Steel Co.*, 205 U. S. 105, the rule adopted is consistent with the reasonable forecast principle. In the *Bethlehem* case, the United States contracted for gun-carriages while preparing for imminent war with Spain. The contract imposed $35 dam-

ages, computed upon the basis of a reasonable formula (205 U. S. at p. 109), for each day of delay in delivery of each gun-carriage. Delay in delivery ensued and the United States deducted the agreed damages. The Bethlehem Company gave evidence that, due to the abrupt end of the war, the delay caused practically no damage, and contended that the amount imposed was disproportionate to the damages actually suffered. This Court held that the damage clause was for liquidated damages and not for a penalty. In the opinion Mr. Justice Peckham stated (p. 121):

> "The amount is not so extraordinarily disproportionate to the damage which might result from the failure to deliver the carriages as to show that the parties must have intended a penalty, and could not have meant liquidated damages."

The distinction between the *Bethlehem* case and the case at bar is clear if one considers the reasonableness of the forecast of damages for (under the reasonable forecast principle) the reasonableness of the forecast is to be determined as of the time when the agreement is made. In the *Bethlehem* case it appeared when the contract was entered into that delay in delivery would result in substantial injury. But in the present case it was known when the contract was made that failure to have the certificates ready on May 18 (unless followed by failure to deliver which would require the imposition of damages under paragraph 9) could not cause any damage whatsoever.

The Court of Claims made certain references, in the same paragraph which cited the *Bethlehem* case (R. 38), to the agreement of the parties and the intendment of the contract as to whether the amount imposed was

liquidated damages or a penalty. This suggests that the Court may have relied upon certain references in the *Bethlehem* opinion to the intention of the parties. But this Court made it clear that the term "liquidated damages" or "penalty," used by the parties is not conclusive in deciding the question (205 U. S. at p. 120). It could not be otherwise for if a statement of intention of the parties were the controlling factor, then every penalty clause, if labeled "liquidated damages," could be enforced. Williston, Contracts (Rev. ed.), § 778.

It thus seems clear that the Court of Claims either misunderstood the rule of the *Bethlehem* case or was unaware of the determinative difference in the facts of the two cases. The *Bethlehem* decision supports the petitioner's right to recover.

The provision imposing damages for omission to have certificates ready on a certain day (under circumstances where there could not be any damage) was inserted in the contract to make more certain that the petitioner, through fear of a heavy exaction, would have the certificates ready on that day; such a provision was a violation of the reasonable forecast rule and was, therefore, a penalty and not enforceable.

It is evident that the purpose of the controverted provision of paragraph 7 (imposing damages in case the certificates were not ready on May 18 where timely delivery was made) was to give greater certainty that performance would be rendered on any day thereafter when the FSCC should give notice and instructions to deliver.

Since the contract did not provide that the petitioner should on or before May 18 give notice to the FSCC that the certificates were ready, the provision could not have been placed in the contract to give the FSCC increased

mental assurance, through receipt of advice of readiness to perform, that the contract would be performed on time. It could have been inserted only to force the petitioner, through fear of a heavy exaction, to have the certificates ready on May 18. The provision was not intended to be a reasonable forecast of probable damage for there could not be any damage, but was designed to be held *in terrorem* over the petitioner.

It may be conceded that in this contract and in any contract there will be greater certainty of timely performance if the promisor is subjected to heavy damage if he has not completed all necessary preparations some days before performance is actually due. But lack of this certainty can not cause actual damage. In spite of not being ready some days beforehand, the promisor may, as in this case, perform when performance is due; if this is done, the promisee does not suffer injury. This fact was as mathematically certain when the contract was entered into as it proved to be afterward.

Whether the provision in question was drafted to give the FSCC increased mental assurance of readiness to perform (which, as mentioned in the second paragraph under the present sub-heading, seems impossible), or to force the petitioner, through fear, to have the certificates ready on May 18, it was clearly not a reasonable forecast of probable damage. As such, it was a penalty and, therefore, not enforceable. Williston, Contracts (Rev. ed.), § 776, pp. 2183, 2184; McCormick, Liquidated Damages, 17 Va. L. Rev. at p. 104 et seq. and p. 111 et seq.; Loyd, Penalties and Forfeitures, 29 Harv. L. Rev. 117 (history of rule).

CONCLUSION

The judgment of the Court of Claims should be reversed and the cause remanded with directions to enter judgment for the petitioner.

Respectfully submitted,

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September, 1947.